TANA OIL & GAS CORP.

IBLA 97-461 Decided December 2, 1999

Appeal from a decision of the New Mexico State Office, Bureau of Land Management, amending a competitive oil and gas lease. TXNM-96120.

Reversed and remanded.

1. Oil and Gas Leases: Acquired Lands Leases--Oil and Gas Leases: Royalties: Generally

The Mineral Leasing Act for Acquired Lands authorizes the leasing of the mineral interest acquired by the United States in the leased lands subject to a royalty of 12-1/2 percent. When the royalty interest in the minerals acquired by the Government is subject to an outstanding enforceable royalty interest held by a third party, the lessee's royalty obligation is limited to 12-1/2 percent and the lease does not require payment of a 12-1/2 percent Federal royalty in addition to the outstanding third party royalty obligation in the absence of a lease term to that effect.

2. Oil and Gas Leases: Acquired Lands Leases--Oil and Gas Leases: Royalties: Generally

A decision unilaterally amending a competitive acquired lands oil and gas lease to require the lessee to pay the full Federal lease royalty in addition to any third party royalty interest will be reversed where it appears the lessee had no notice of the outstanding royalty interest or of the obligation to pay that third party royalty in addition to the Federal lease royalty.

APPEARANCES: Bruce L. Collins III, Esq., and David W. Prehn, Esq., Corpus Christi, Texas, for the Tana Oil and Gas Corporation.

OPINION BY ADMINISTRATIVE JUDGE GRANT

The Tana Oil and Gas Corporation (Tana or appellant) has appealed from a decision of the New Mexico State Office, Bureau of Land Management

(BLM), dated May 23, 1997, with respect to its Federal oil and gas lease (TXNM-96120). That decision rejected appellant's assertion that third-party royalty interests described as "Non-Participating Royalty Interests" (NPRI's) which were asserted to be outstanding on the leased lands were to be paid from the royalty owing to the Federal Government under the terms of the oil and gas lease. The BLM decision purported to "amend" the lease terms to indicate that any third-party royalty obligation is separate from and in addition to the royalty obligation owed to the Federal Government.

At a competitive oil and gas lease sale held by BLM on October 18, 1995, Tana, which owns oil and gas lease rights to adjoining tracts of land, submitted a competitive bid, in the amount of $90/acre for 1,605 acres of acquired land situated in "Tract A-2-M-1," Jasper County, Texas (Parcel No. 95-10125). Along with its bid, Tana paid the total bonus bid ($144,450), plus the first year's advance rental ($2,407.50) and an administrative fee. It is asserted by appellant that nothing in the sale notice or other information provided by BLM at the time of the sale informed Tana that any portion of the tract might be subject to an NPRI. (Affidavit of Donald Popejoy, dated Aug. 29, 1997 (Ex. C attached to Statement of Reasons for Appeal (SOR)) at 1-2.)

Subsequently, BLM declared Tana the high bidder and issued a competitive oil and gas lease to Tana for Tract A-2-M-1, effective November 1, 1995, for a term of 10 years and so long thereafter as oil or gas was produced in paying quantities, pursuant to the Mineral Leasing Act for Acquired Lands, as amended, 30 U.S.C. §§ 351-360 (1994). The leased land, which is within the "Sam Rayburn Reservoir Project," is under the administrative jurisdiction of the U.S. Army Corps of Engineers (Corps).

The United States, which had previously acquired the surface estate in the land, purchased the mineral estate in Tract A-2-M-1, which was part of the Thomas McGalin Survey (Abstract No. 26). The mineral interest was conveyed by a mineral deed, dated February 17, 1964, from the Humble Oil and Refining Company (Humble). By its terms, the deed indicated that Humble held title to the oil, gas, and other minerals in the tract "subject to certain non-participating royalty interests." (Mineral Deed at 1.) These interests were not specified in the deed. A "Preliminary Certificate of Title," dated November 19, 1963, prepared in connection with acquisition of the mineral estate stated that the grantor held title to the oil, gas, and other minerals and an undivided 0.89583333-percent interest in all royalties therein, detailing certain outstanding royalty interests in third parties.

Section 2 of the lease issued to Tana requires the lessee to pay to the United States a 12-1/2 percent (1/8th) royalty on the value of oil and gas produced from the leased lands. Subsequent to issuance of the lease, Tana obtained BLM approval for permission to drill a well on the leased lands and such efforts resulted in the production of oil and gas, beginning February 20, 1996, from the Henry Taylor No. 1 well.

On May 28, 1996, Tana notified BLM that it had become aware, by virtue of a November 8, 1995, title opinion prepared by its attorneys, that, at the time the United States acquired the mineral estate in the leased lands in 1964, there were three outstanding NPRI's, which had been created in 1932-33. (Letter to BLM, dated May 23, 1996, at 1 (referring to attached Title Opinion).) These interests consisted of a 1/16th royalty on oil, which had been conveyed to the Arriola Royalty Corporation by Humble on December 29, 1932; a 1/24th royalty on oil, which had been conveyed to the Southwestern Lumber Company of New Jersey (SLC) by Humble on February 7, 1933; and a 1/8th royalty on gas, which had been reserved by SLC in a conveyance to Humble on February 7, 1933. Id.; see Title Opinion at 14-15. Tana stated that the Federal lease is "subject to" these "perpetual" NPRI's and that, once these interests were "deducted" from the Federal royalty interest (1/8th), the United States was "left" with a 1/48th royalty interest on oil and no royalty on gas produced from the leased lands. (Letter to BLM, dated May 23, 1996, at 1.)

By letter dated August 5, 1996, the Corps, the agency with custody of the title records for these lands, 1/ responded to an inquiry from BLM forwarding Tana's assertions regarding the outstanding NPRI's. The Corps initially informed BLM that, relying solely on the representations made in the Title Opinion, the mineral estate in the leased lands "appears to be subject to [NPRI's]." (Letter, dated Aug. 1, 1996.) Later, upon further prompting, the Corps, on February 10, 1997, opined that NPRI's "can negate all, or a portion, of the royalties due to [the] landowner under the terms of an oil, gas and mineral lease," even when the land is owned by the United States. (Letter to BLM, dated Feb. 7, 1997.) Thus, the Corps concurred in Tana's assertion that it was required to pay almost all of the 12-1/2 percent royalty, normally payable to the United States on the value of oil and gas produced from the leased lands, to the NPRI's.

Prior to issuing its May 1997 decision, BLM consulted with the Field Solicitor's Office in Santa Fe, New Mexico. Based on the opinion of the Field Solicitor, BLM rejected Tana's contention that the royalty obligation to NPRI's is properly offset against the Federal royalty due the United States under the lease:

> We note that federal law and regulations require the payment of the 12 1/2 per cent royalty on the value of production of federal oil and gas leases. 30 U.S.C. § 226 [(1994)]; 43 CFR 3103.3-1(a)(1). We are not aware of any exception that allows for "NPRI" to be paid from out of this statutory rate. The federal royalty rate is a statutory requirement.

1/ The Corps has responsibility for administration of the surface estate but not the minerals in the acquired lands within the project.

> Therefore, we disagree with the arguments of Tana and the Corps of Engineers that there is any ambiguity to be resolved by reference to Texas state law.

(Decision at 1 (quoting from Memorandum to Deputy State Director, Lands and Minerals, New Mexico, BLM, from Field Solicitor (Field Solicitor Memorandum), dated May 6, 1997, at 1).) Further, BLM recognized, as did the Field Solicitor, that the normal practice, when it had notice at the time of a competitive lease sale that there might be an outstanding NPRI which was to be paid separate and apart from the royalty due the United States, was to notify the potential lessees of that fact. Further, BLM acknowledged that such notice had not been given in the present case. (Memorandum to Field Solicitor from Deputy State Director, Resource Planning, Use and Protection, New Mexico, BLM, dated Mar. 17, 1997, at 1; Field Solicitor Memorandum at 1.) Thus, relying on the concurrence of the Field Solicitor, BLM amended Tana's oil and gas lease, so as to notify the lessee of the NPRI's. It did so by incorporating the following provision in the lease: "This tract may have an outstanding Nonparticipating Royalty Interest (NPRI), which is a separate royalty payment in addition to the royalty paid to the United States under the terms of any BLM lease issued, and is paid by the lessee directly to the NPRI owner." (Decision at 2.)

In its SOR, Tana asserts that an NPRI is an expense-free interest in oil or gas if and when it is produced. Appellant contends that under relevant case law an outstanding NPRI is properly paid out of the lessor's royalty interest and not the lessee's working interest. (SOR at 2.) In support, Tana cites the decision of the court in Mafrige v. United States, 893 F. Supp. 691 (S.D. Tex. 1995), and the opinion of the Comptroller General of the United States at 30 Comp. Gen. 74 (1950). Tana asserts that the mineral estate acquired by the United States is subject to the outstanding perpetual NPRI's previously created. (SOR at 4.) Appellant points out that its oil and gas lease states that the Federal interest in the acquired land is 100 percent. Id. Tana contends that in the absence of a lease provision requiring it to pay in excess of 12-1/2 percent royalty, the royalty reserved to the lessor is properly reduced by the amount of royalty outstanding in other parties. Id. at 12, citing 1 Williams & Meyers, Oil and Gas Law, p. 632.2 (1996). Further, Tana asserts that if it has to pay both the NPRI royalties and the full 12-1/2 percent lease royalty, it will be forced to pay a royalty of almost 25 percent rather than the 12-1/2 percent required in the lease. (SOR at 7.) Appellant contends the BLM decision to unilaterally amend the oil and gas lease after production was obtained was arbitrary and capricious and contrary to precedent. Id. at 12-14. Further, Tana argues that BLM's decision to amend the contract violated its contractual rights under the oil and gas lease. Id. at 16-17.

As a general rule, a Federal lessee is required to pay a royalty of at least 12-1/2 percent on the value of oil and gas produced from leased lands to the Federal Government. Section 3 of the Mineral Leasing Act for Acquired Lands, as amended, 30 U.S.C. § 352 (1994), provides that oil and gas deposits on acquired lands are to be leased "under the same conditions as contained in the leasing provisions of the mineral leasing laws." Thus, production royalty, in the case of competitive leases, is to be paid on the basis of section 17(b)(1)(A) of the Mineral Leasing Act, as amended, 30 U.S.C. § 226(b)(1)(A) (1994), which states: "A lease shall be conditioned upon the payment of a royalty at a rate of not less than 12.5 percent in amount or value of the production removed or sold from the lease." Similarly, the Departmental regulations provide: "Royalty shall be paid in amount or value of the production removed or sold as follows: (1) 12½ percent on all leases." 43 C.F.R. § 3103.3-1(a). This requirement is also set forth in section 2 of appellant's Federal lease at issue here: "Royalties shall be paid to proper office of lessor. Royalties shall be computed in accordance with regulations on production removed or sold. Royalty rates are: * * * Competitive lease, 12½%."

[1] The Mineral Leasing Act for Acquired Lands, by definition, applies to the mineral interest in lands acquired by the United States, including interests acquired by deed. 30 U.S.C. § 352 (1994). It is a well recognized principle of property law that the grantee of an interest in real property generally acquires no better title through his deed than that held by his predecessor-in-title. See McCommons Oil Co., 138 IBLA 55, 57 (1997). Thus, unlike public domain land, the mineral estate held by the United States in acquired lands is subject to the limitations of the grantor's title. 2 The Rocky Mountain Mineral Law Foundation, Law of Federal Oil & Gas Leases § 20.06, at 20-28 (1996). The evidence in the record before us suggests that the mineral title acquired by the United States is subject to outstanding NPRI's created by a predecessor-in-title. An NPRI has been defined as "[a]n expense-free interest in oil or gas, as, if, and when produced. The prefix 'nonparticipating' indicates the interest does not share in bonus or rental, nor in the right to execute leases or to explore and develop." 8 Williams & Meyers, Oil and Gas Law 687 (1997). A valid outstanding NPRI has been recognized as limiting the royalty interest of the lessor in minerals encumbered thereby effectively reducing the lessor's share of royalty reserved in subsequent oil and gas leases. 1 Williams & Meyers, Oil and Gas Law § 316.3 (1997), citing Klein v. Humble Oil and Refining Co., 126 Tex. 450, 86 S.W.2d 1077 (1935).

In the Mafrige case involving NPRI's outstanding in tracts of acquired land purchased by the Federal Government, the court denied the Federal Government's motion to dismiss the claim of the grantor to royalty on production under the Federal oil and gas lease. The court found that the obligation of the Federal oil and gas lessee pursuant to the lease terms and the Mineral Leasing Act for Acquired Lands, 30 U.S.C. § 355 (1994), to pay the lease royalty to the United States is subject to the limitation that the Federal Government can only lease the mineral interest which it owns in the leased lands. Mafrige v. United States, 893 F. Supp. at 702. Further, the court held that the statute under which the land was acquired gave the Federal Government the authority to purchase an executive interest in the mineral estate consisting of the right to lease the mineral fee, subject to the related duty to lease the minerals for the benefit of the NPRI owners. Id. at 703.

As noted by appellant, the question of whether royalty payable to the Federal Government on production under Federal oil and gas leases issued for lands which were acquired subject to a reservation of a royalty interest of 6-1/4 percent was properly reduced from the statutory rate of 12-1/2 percent to a balance of 6-1/4 percent remaining after payment of 6-1/4 percent to the holder of the reserved royalty interest has been addressed by the Comptroller General. Finding that statutory authority for issuing Federal oil and gas leases in situations where the Federal Government owns less than a full interest in the minerals is provided by section 5 of the Mineral Leasing Act for Acquired Lands, 30 U.S.C. § 354 (1994), the Comptroller General held that the royalty obligation of the lessee under the statute was limited to 12-1/2 percent regardless of the fact that payment of royalties due to the former owner pursuant to the reservation serves to reduce the royalty payable to the United States to the extent of payment of the reserved royalty. 30 Comp. Gen. 74, 75-76 (1950).

[2] Accordingly, we find that in the absence of a lease term expressly providing for payment of Federal royalty in the amount of 12-1/2 percent in addition to payment of any outstanding NPRI's, the mineral interest leased pursuant to the Federal oil and gas lease is subject to any legally enforceable outstanding NPRI's created by deed or reservation which limit the mineral estate held by the United States. The BLM decision under appeal purported to "amend" appellant's oil and gas lease to correct an administrative error and provide that any royalty paid to the holder of an NPRI is in addition to the Federal royalty paid under the lease.

This Board has previously had occasion to consider the validity of lease stipulations or terms imposed by BLM subsequent to lease issuance. In reviewing the effect of lease stipulations unilaterally imposed by BLM after lease issuance in the context of noncompetitive oil and gas leasing, we held that "a lease issued without notice to the offeror, prior to issuance of the lease, of an additional stipulation is not binding on the offeror and is without effect, in the absence of acceptance of the stipulation." Emery Energy, Inc., 64 IBLA 175, 177-78 (1982), reaffirmed on reconsideration, 67 IBLA 260. In the case of noncompetitive lease offers in which the stipulations were imposed by BLM at the time the executed leases were returned to the lease offerors, we found that the leases were without effect and should be cancelled by BLM. 64 IBLA at 179. In the context of competitive oil and gas leasing, we have held that notification of the stipulation in the notice of lease sale obligated the lessee to accept the stipulation. Palmer Oil and Gas Co., 43 IBLA 115, 117 (1979); see 43 C.F.R. §§ 3101.3, 3120.4-1(c). Appellant has asserted that it had no indication from BLM in the competitive lease sale notice or otherwise at the time of the sale that there was an outstanding NPRI in addition to the Federal royalty obligation. We find nothing in the record to rebut this contention. In the absence of such notice, we find no basis to uphold the unilateral amendment of the lease term to require payment of Federal royalty in addition to any legally valid outstanding NPRI. Consequently, the decision appealed from is reversed to the extent it amends the lease to state that any outstanding NPRI is a separate royalty payable by the lessee in addition to the royalty payable to the Federal Government under the Federal oil and gas lease.

We note, however, that the record is lacking a title abstract and an opinion regarding the validity of the outstanding NPRI's. We further recognize that severed and/or dormant mineral interests are frequently subject to recordation statutes invalidating such interests to the extent that they are not recorded in compliance with statutory requirements. See Texaco, Inc. v. Short, 454 U.S. 516 (1982) (upholding the constitutionality of the Indiana Dormant Mineral Interests Act which provided that a severed mineral interest lapses and reverts to the current surface owner of the property unless the mineral owner files a statement of claim in the county recorder's office within the 20-year period or within a 2-year grace period after enactment). Accordingly, we find it appropriate to remand this case to BLM to obtain an analysis by the Solicitor's Office of the validity and extent of the NPRI's.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the decision appealed from is reversed and remanded to determine the validity and extent of the NPRI's which may limit the Federal royalty interest.

C. Randall Grant, Jr.
Administrative Judge

I concur:

Bruce R. Harris
Deputy Chief Administrative Judge